NATIONAL CREDIT UNION ADMINISTRATION

NCUA News

July 1997, Number 6

HIGHLIGHTS

Final Investment Rule Adopted

The National Credit Union Administration Board June 12 unanimously adopted a final investment rule that establishes parameters for risk assessment while permitting credit unions to operate flexibly within those parameters.

Rule Ensures CU Boards Understand and Assess Risk

The intent of the final rule on Investment and Deposit Activities, Part 703, is to ensure that credit unions' boards of directors and management authorize the purchase of investments they understand. A three-tier system will determine at which level of requirements a credit union will operate based on the complexity of risk in its investment portfolio. Regulatory burden is minimized for credit unions with a simple portfolio of investments.

"Many credit unions will see the requirements in Part 703 as nothing more than an extension of existing investment polices and procedures," noted NCUA Chairman Norman E. D'Amours. "Others will have to take another look at what they are doing and decide if they should alter investment strategies to ensure that their boards adequately control risks."

The final rule is written in a "plain language" question and answer format. It shifts NCUA's focus from emphasis on specific instruments purchased by credit unions to the risk management of investment activities. It clarifies a number of areas, adds restrictions on certain securities determined to be inappropriate for credit unions, broadens authority in certain areas, and requires a credit union's staff and board of directors to meet certain safety and soundness standards with regard to the potential risks of the investment options.

Three Levels of Risk

Credit unions must establish their risk limits and then measure, monitor, and control the risks they decide to take. NCUA examiners will review policy statements during routine, annual examinations and, when appropriate, make recommendations for modification.

The regulation implements three levels of requirements. At the simplest level, if a credit union wants to limit its investments to certificates of deposit and corporate credit union deposits, it does not have to monitor their value. At the second level, if it chooses to buy securities, it must keep track of their changing value and report this information to its board. The credit union's board determines that the securities are within policy limits.

The most reporting requirements apply at the third level for credit unions that want to purchase securities with potentially greater risk. Portfolios must be shock tested quarterly when the sum of securities with any of the following characteristics is greater than capital:

1. embedded options; or
2. maturities greater than three years; or
3. coupon formulas are related to more than one index or are inversely related to, or multiples of an index.

Pilot Program Added

While the final rule takes effect Jan. 1, 1998, NCUA is beginning a new Pilot Program this month. Effective July 18, 1997, NCUA will accept and begin reviewing a limited number of requests from federal credit unions that want to engage in investment activities permitted by the FCU Act but prohibited under the regulation.

Incorporated in the new rule, the Pilot Program will benefit credit unions and NCUA. It gives federal credit unions the flexibility to "test the waters" with certain investments and allows NCUA to monitor and respond to changes in the market while gaining experience gradually as new investment products and services emerge.

Update on FOM Cases

June 23 — NCUA filed a Motion in response to an Order from the D.C. Circuit Court of Appeals asking the Court to suspend further proceedings pending the Supreme Court's disposition of *NCUA v. First National Bank & Trust Co.*

CUNA and NAFCU joined NCUA in the Motion appealing the District Court's broad application of the original AT&T Family FCU decision to all federal credit unions and its conclusion that the decision not only barred the addition of new select employee groups but also the addition of new members to existing occupational groups that did not share a common occupational bond with a credit union's core membership.

By July 14 — NCUA will file a petition for certiorari asking the U.S. Supreme Court to review the April 14 field of membership decision of the U.S. Court of Appeals for the Sixth Circuit in *First City Bank v. NCUA.* That decision invalidated NCUA's multiple occupational group policy as applied at Tennessee-based AEDC Federal Credit Union. The Sixth Circuit has stayed its instruction to the District Court to implement the decision. In our petition in *First City Bank*, NCUA will base our legal arguments on lack of standing and the merits already asserted in the AT&T case. If the Supreme Court grants certiorari in *First City Bank*, NCUA will ask that the case be held pending a decision in the AT&T case since both the AT&T Family and AEDC cases raise essentially the same issues.

News Briefs

- Call Reports Mailed — *Mid-Year Call Reports* must be submitted by all federally insured credit unions by July 24. This year's redesigned two-section report, available in *Windows* and *DOS*, clearly identifies the 5-page section that all credit unions complete and the specific schedules credit unions submit when involved in more complex operations. The form was redesigned to simplify reporting, especially for smaller credit unions.

- Cyberbanking — NCUA includes electronic financial services in a Critical Issues Training Seminar being presented to select staff this year. Examination procedures are undergoing limited testing at two federal credit unions with home banking. Currently, nearly 900 credit unions have Homepages posted on the WWWeb.

- Corporate CU Training — Corporate credit unions had two days of training available to them detailing the new corporate credit union rule and the requirements of the approval process for expanded authorities.

NCUA News

NCUA News is published by the National Credit Union Administration, the federal agency which supervises and insures credit unions.

Norman D'Amours, *Chairman*
Shirlee P. Bowné, *Vice Chairman*
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- PCS Holders File Appeal — The Preferred Capital Shareholders of Capital Corporate FCU have filed an appeal with the U.S. Court of Appeals for the Fourth Circuit seeking to reinstate their lawsuit against NCUA, which was dismissed in April by the U.S. District Court in Alexandria. If the appeal succeeds, the dismissal would be reversed and the case will proceed to trial. The appeal is unlikely to be decided before mid-1998.

Board Actions Scheduled for July 23 includes:

- Change to Section 701.21(h), proposed Part 723, Member Business Loans;
- Amendments to IRPS 94-1 to clarify what documentation is necessary to obtain a community charter
- Charter Conversions

Conversion Requests Approved

The NCUA Board in June approved requests for community charter conversions from Northwest Consumers FCU, Traverse City, Michigan, and Kennedy Space Center FCU, Merritt Island, Florida.

Gaining a community charter will allow $8.7 million Northwest Consumers FCU to serve the 64,273 people who live, work, worship, or attend school in Grand Traverse County. The credit union will continue to serve its current 2,388 members — division and regional employees at the downsizing Consumers Power Company and other groups located throughout the community.

A U.S. and State Senator sent letters supporting the proposed charter conversion along with 8 of 14 township leaders and several business entities. A telephone survey of households overwhelmingly supported the conversion and area residents have expressed their desire to gain credit union service

A community charter will give $173 million Kennedy Space Center FCU the opportunity to serve the 525,200 Florida residents who live, work, worship, or attend school in and businesses and other legal entities located in Volusia and Brevard Counties. This action allows the credit union to expand beyond its current membership from NASA, Cape Canaveral and multiple select employee groups. It also ensures that the credit union can serve a number of low-income communities in both counties.

NCUA Regions Report

NCUA's regional offices report that one federal credit union was chartered in May. Turtle Mountain Federal Credit Union of Belcourt, ND, was chartered to serve 15,000 potential members of the Turtle Mountain Band of Chippewa Indians.

Other activities reported for May includes:

- 29 federal credit unions received field of membership amendments;
- 16 credit unions merged;
- 5 federal credit unions converted to state charter, and
- 10 state-chartered credit unions gained federal insurance coverage.

Census Tracts for HMDA Reporting Available on the Web

The Federal Financial Institutions Examination Council (FFIEC) has geographic statistical tracking for the entire country available on its web site at http://www.FFIEC.gov. When a user enters a complete address, the web will retrieve the associated metropolitan statistical area, state, and county codes and the tract block numbering area code. The application also provides helpful census demographic information about the median income percentage, income dollar levels, total population, minority population, and the number of housing units for the tract selected.

Credit unions will find the FFIEC Geocoding System useful in complying with Home Mortgage Disclosure Act requirements. Historically, many HMDA reporting errors are related to incorrect census tract reporting on the HMDA Loan Application Register.

Generally, credit unions over $28 million in assets that offer real estate loans are required to comply. To find out if your credit union must comply with HMDA, the publication *A Guide to HMDA Reporting, Getting it Right* is available for $5. It is number 9003 on NCUA's publication list included in last month's NCUA NEWS. To order, call NCUA at 703-518-6340.

"Letters to the NCUA Board"

NCUA periodically prints letters sent to NCUA board members from credit union constituents. The following letter was sent by Tom Hughes, VADM, USN (Ret.), past President/CEO of $9 billion-asset Navy FCU, Vienna, Virginia.

June 12, 1997

Dear Mr. Chairman,

Last year, NCUA in coordination with the major credit union trade associations led a symposium in Chicago, 9-11 August under the title of "Serving the Underserved." We hoped that the results would stimulate larger, healthy credit unions to cooperatively help low income credit unions to better serve their members, as well as encourage all credit unions to focus on penetrating more of the underserved segments within their own fields of membership.

Ten months have passed and I am concerned that our industry hasn't been as proactive in meeting this challenge as we envisioned.

It is clear that the bankers' attack has been a significant factor in deterring our progress. The trades, in responding to higher priority demands of their members, have focused their collective emphasis entirely on the "Credit Union Campaign for Consumer Choice." I agree that combating the bankers' attack has become a basic need for survival. But I am deeply convinced that we would be negligent to ignore the need to enthusiastically embrace the "cooperative spirit." This should be the defining measurement for the entire movement, not just a few credit unions.

While NCUA sounded the alarm, the regulator is not the best agent to implement corrective actions. Effectiveness would best be obtained on the local level. There are various existing credit union networks to facilitate the process of helping each other and repairing the lack of trust that small credit unions continue to feel for larger credit unions.

First, credit unions should develop more local mentoring programs to make the low income credit unions feel comfortable with a helping relationship. Then the following could take place:

- *Mentors could make non-member deposits, keep in touch and exchange visits and calls, offer printing and marketing services, pay dues for their membership in the trades and/or pay for attendance/registration at some educational meeting;*
- *The trades could encourage their regional or league representatives to be more proactive in assisting low income and community development credit unions (CDCUs);*
- *The trades could keep CDCUs better informed of educational and issue specific forums scheduled for their local areas, and suggest that the paired mentor credit unions assist the CDCUs in attending. Registration fees should be waived; and*
- *NCUA could help in pairing, and getting their Regional Directors involved in flagging needs to potential mentors as a result of examination findings; NCUA could publicize good performance; and circulate helpful insights through "NCUA Letters to Credit Unions".*

Taking these, and several other, steps will help to defeat banking industry efforts not only to limit our fields of membership, but to tax us and subject us to bank-like CRA requirements. Such unified activities will put us in better position to fight off banker charges by demonstrating conclusively that credit unions are, however large, financial entities committed to working cooperatively in serving the underserved.

Good communications are important to the success of cooperatives. We must get this program down to local levels of credit unions and have credit unions helping other credit unions, while continuing to help their own members.

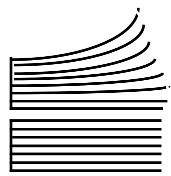
Any input or guidance NCUA can lend to this effort would be greatly appreciated.

Sincerely,

Thomas J. Hughes, VADM, USN (Ret.)
past President/CEO,
Navy Federal Credit Union

GC Opinion Letters

The NCUA Office of General Counsel responds to written requests for legal interpretations of the *Federal Credit Union Act and NCUA Rules and Regulations*. Summaries follow of some of the latest letters issued that may interest the credit union community. These legal opinions can be secured by writing to the Office of Public and Congressional Affairs, 1775 Duke Street, Alex., VA 22314-3428. Please provide the identifying number and title when making a request. General Counsel opinion letters are also available electronically on the NCUA web site at http://www.ncua.gov.



No. 97-0544 ***Life Savings Insurance*** — NCUA does not require or regulate life savings insurance. State insurance and contract laws control issues concerning disputes on member life savings insurance. *May 29, 1997*

No. 97-0326 ***Membership Eligibility*** — Immediate family members of a secondary member are not eligible to join a federal credit union. — *June 9, 1997*

No. 97-0533 ***Real Estate Related Loans*** — A signature loan used for home improvements is a real estate related loan and must comply with the requirements of Section 701.31, *NCUA Rules and Regulations. June 19, 1997*

No. 97-0423 ***Statutory Lien*** — An FCU can only use its statutory lien authority to impress and enforce a lien to recover a member's loan obligation or, if the member has an overdraft protection agreement, an overdraft deficiency. However, charges associated with share account fees, such as returned check fees, are recoverable under a separate authority. An FCU can adopt a policy, through a nonstandard bylaw amendment or board resolution, that allows the credit union to transfer funds from a member's other accounts to cover a negative share balance. *June 19, 1997*

Correction: The state of Missouri should be included to the list of states reported last month that Indiana Corporate Federal Credit Union gained expanded authority to serve.

ABOUT INVESTMENTS

Monitor Government-Sponsored Enterprise Investments

Government-Sponsored Enterprises (GSEs) are government sanctioned financial intermediaries originally established to provide funding to various sectors of the US economy in need of credit financing beyond that supplied by wholly private financial intermediaries. Because GSEs, as a group, are so closely associated with the federal government, they are often viewed (incorrectly) as official government agencies. Seven GSEs with debt securities outstanding are: Federal Home Loan Bank System (FHLB); Federal Home Loan Mortgage Corporation (Freddie Mac); Federal National Mortgage Association (Fannie Mae); Farm Credit System; Federal Agricultural Mortgage Corporation (Farmer Mac); Student Loan Marketing Association (Sallie Mae); and Financing Corporation (FICO).

As their names suggest, the first three GSEs provide service to the funds markets for home purchasers; the next two, agriculture operations; the next, the market for student loans; and the last provided funding for the Federal Savings and Loan Insurance Corporation (FSLIC).

Although the securities of these GSEs are called "agency" securities, the GSEs are not federal agencies. Two factors distinguish GSEs from credit programs directly affiliated with the federal government: private ownership and lack of explicit federal guarantees on principal indebtedness.

Because GSEs are privately owned, they are excluded from the federal budget, though some enjoy borrowing privileges from the Treasury. Additionally, any financial gains/ losses from GSE operations are distributed to stockholders. The absence of explicit federal guarantees on GSE indebtedness means that their debt securities carry some credit risk. Because of this incremental risk, GSE debt yields are normally slightly higher than those of comparable Treasury securities.

GSEs sell securities to the public through dealer syndicates specializing in debt pricing and distribution. Dealers in these syndicates generally support secondary trading of the issues they sell; specifically, dealers purchase GSE debt for resale to investors and may buy the securities for their own proprietary accounts.

The volume of trade in GSE debt securities is small relative to that of Treasury securities; however, the market is sufficiently broad to ensure there securities generally are liquid. Most trading is concentrated in the relatively shorter maturities.

A credit union needs to recognize that there is some credit and liquidity risk, and that thatthere is , not a large secondary market for some issues. Therefore, a credit union should monitor any legislative efforts or market factors that may effect the price or status of securities issued by Government Sponsored Enterprises.

Board Member Yolanda Townsend Wheat (center left) congratulated EasCorp President Jane Sansone (center right) and her Board of Directors for another successful year serving their member credit unions. As the keynote speaker at EasCorp's 19th Annual Meeting in Boston, Wheat said that input from both natural person and corporate credit unions led to the development of a corporate regulation which maintains safety and soundness while providing flexibility.

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